NATIONAL FORECAST DESCRIPTION
The Forecast Period is the Second Quarter of 1999 to the Fourth Quarter of 2003

This fall finds the U.S. economy hurling toward another record. It posted the longest peacetime run of growth in December 1998. Early next year it should pass another milepost, when it becomes the longest expansion, period. The current record is held by the 116-month Vietnam-era expansion that ran from 1961 to 1969. Records going back past the Civil War show that the average expansion lasted 35 months. They also show that peacetime expansions averaged about 29 months. Wartime expansions tended to last longer, an average of 64 months. So far, only four peacetime expansions have outlived the shortest wartime expansion. The current expansion turns 103 months old this October.

Despite its advanced age, the current expansion shows few signs of ending. Real GDP has grown faster than its estimated potential pace of 2.5% in every year since 1995. Inflation has remained tame even though the unemployment rate has plunged below almost every estimate of full employment. Euphoric consumers have spent money faster than they made it since 1993. Consumers have financed this shopping spree by pushing consumer debt to record levels and turning the personal savings rate negative. One of the reasons for the consumers’ ebullience was the soaring stock market. Consumers felt the rapidly appreciating stock market was doing the saving for them. It is hard to argue with this strategy since household financial assets have grown about 10% annually since 1995. Consumers also seem more comfortable with the inherent risks of the stock market. Under these circumstances it is understandable that few observers see economic storm clouds gathering on the horizon.

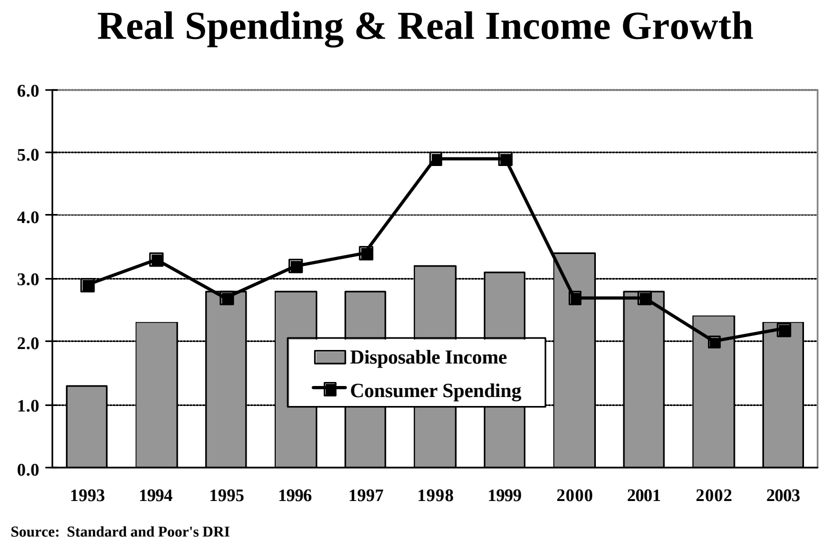
While there are no glaring threats to the current expansion, it is far too early to declare the business cycle dead. One need just dig a little deeper to find potential imbalances that could threaten the economy’s growth streak. First, inflation could rise faster than expected. Price increases have been held in check thanks to the combination of productivity gains, the strong dollar, global competition, and low commodity prices. Recent growth in Asia and OPEC production limits could cause energy prices to rise. Second, a weak dollar and strong Asian economy could cause the foreign funds that helped fuel the U.S. expansion to dry up. Third, American consumers may finally grow tired of spending more than they make and become savers once again. This would reverse the economy’s major growth engine. Fourth, the Y2K bug may bite us still. It is anticipated that an inventory build up will take place prior to January 1, 2000 in order to prevent any supply disruptions. If the impact of Y2K is minor, there will be a slowdown early next year as inventories are worked down. On the other hand, if there were major supply interruptions, production would suffer early next year. Fifth, continuing anti-inflationary tightening by the Federal Reserve may prick the stock-market bubble. A major stock-market correction could throw cold water on consumer confidence and hurt spending.

While the September 1999 DRI macroeconomic forecast shows the U.S. economy growing over the next few years, there is the possibility that it could suffer a recession. It is speculated that if it occurs it will take one of two forms. In the first scenario, a recession is triggered by a collapse in the stock market that is assumed to take place in 2001. In the second scenario, the expansion ends in a more traditional way as the economy overheats. In an effort to control the resulting inflation, the Fed tightens. As a result, the economy falls into a short recession. Both scenarios are explored in the Alternative Forecasts section of this report.

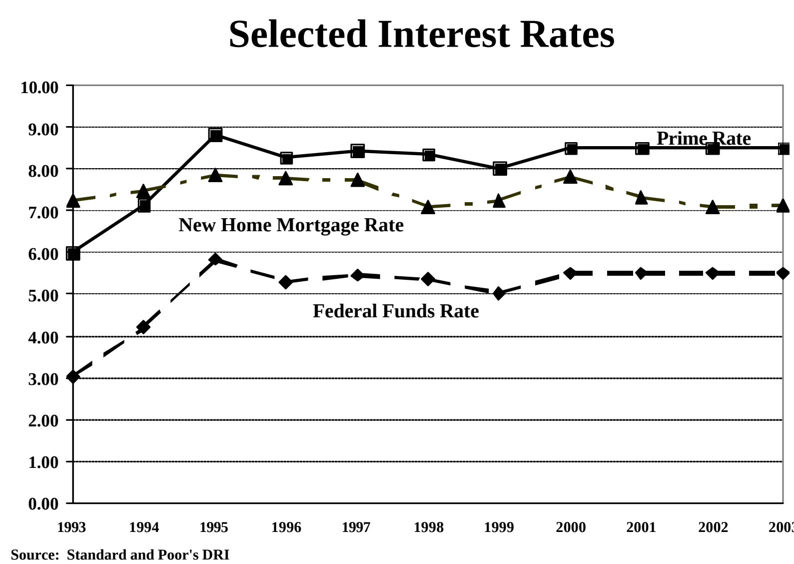
SELECTED NATIONAL ECONOMIC INDICATORS

Consumer Spending: Once again it is predicted that real consumer spending growth will soon slow to about the pace of real disposable income growth. This forecast has been made for several years now.

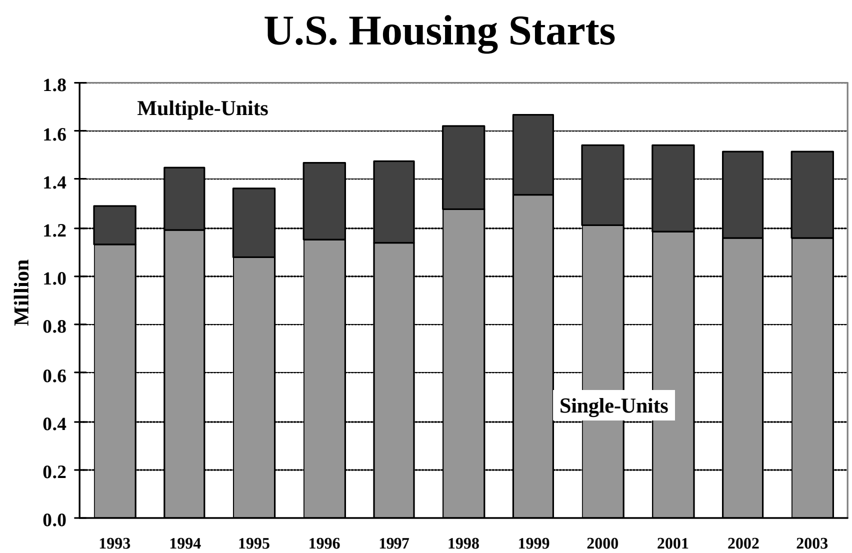
Income growth serves as a natural speed limit for spending. While spending can rise faster than income for short periods, at some point it should return to the rate of income growth. This is because consumers eventually exhaust savings and credit sources that allow them to keep spending. However, American consumers have proven very adept at keeping spending levels high during the current expansion. Real spending has grown faster than real income in every year since 1995 and this gap has widened over time. Real spending and real income grew at about the same pace in 1995, but by 1998 spending advanced 1.7 percentage points faster than income. Fueling this growth was the record level of consumer confidence during this period. Optimistic with their economic lot in life, Americans went on a spending spree. When income did not cover their bills, consumers turned to their savings and credit. Both entered uncharted waters. The personal savings rate sunk from nearly 6.0% in 1992 to virtually zero last year. Most people felt this source for spending was tapped out. However, the personal savings rate actually was negative in 1999, as consumers fought hard to maintain their spending habits. One of the reasons for consumers' seemingly risky behavior is because they believe the rising stock market is doing their saving for them. Rising confidence and low interest rates have also convinced consumers to take on record levels of debt during this expansion. It was believed that consumers had exhausted their taste for debt when the ratio of non-mortgage consumer debt to disposable income was around 18% in 1994. Since then it has become obvious that consumers are comfortable with higher levels of debt. The ratio of debt to income was just over 21% in 1998 and showed no sign of easing in 1999. Keep in mind this debt excludes vehicle leases. One study shows their inclusion would add about 2 percentage points to the debt-to-income ratio. The current consumer euphoria is expected to decline as the economy slows and stock market gains return to the single-digit range over the next few years. As a result, real spending should head south toward disposable income growth. At this pace, however, there will be little extra to rebuild personal savings or work down debt.



Financial: The Federal Reserve Bank chose not to raise its bellwether short-term federal funds rate during its October 5, 1999 meeting. However, it did leave the door open for further hikes down the road. In fact, it confirmed its commitment to fighting inflation in the press release following its October 5th meeting. This forecast assumes the Federal Reserve will tighten again before this year is over. There are several reasons for this outlook. The Federal Reserve guards its political independence. Therefore, it traditionally avoids



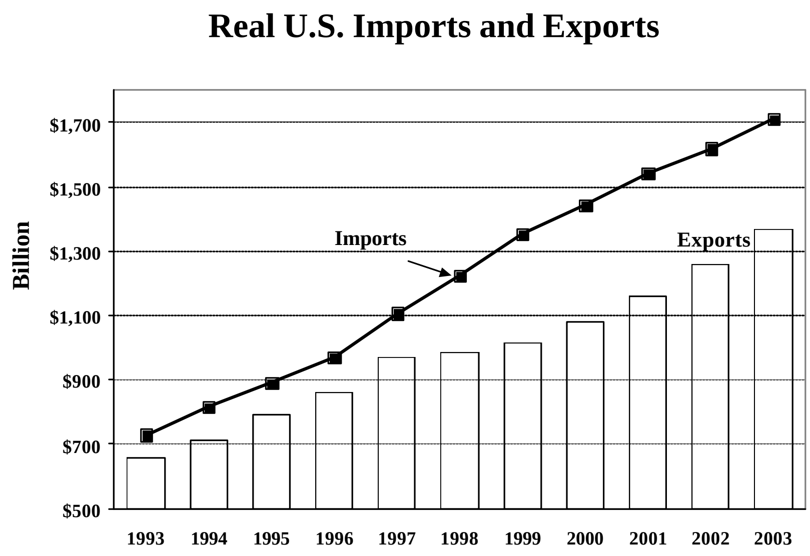
policy changes during election years because they could be construed as politically motivated. The Federal Reserve has gone on record that it is pursuing a neutral policy. The recent round of tightening seems inconsistent with this goal. However, it does make sense when viewed in the longer run. Last year the nation's central bank lowered the federal funds rates in three 25-basis point increments to salve financial market qualms following Russia's debt default. The Federal Reserve's increases this year would reverse last year's reductions. Although the Federal Reserve has committed to a neutral monetary policy, it has not abandoned its inflation fight. Of course, the mild inflation picture makes Alan Greenspan a general without a war. But he will have two more opportunities to launch a preemptive strike against inflation before the end of this year.



Source: Standard and Poor's DRI

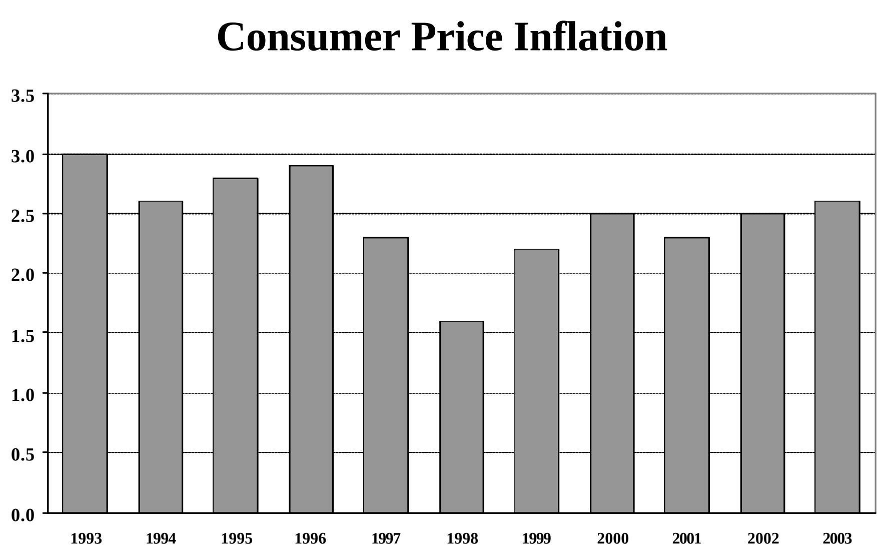
Housing: It would be an understatement to say the housing sector's performance has been a pleasant surprise. For the last few years it has been expected to slow, and in those years it turned in stellar performances. This year is no exception. The nation's housing sector continued to post impressive gains through the summer of 1999 despite a 90-basis point interest rate increase that started last spring. New home sales continued to climbed to about 980,000 in both June and July. They were right below the monthly sales record set in November 1998. Existing home sales were at an annual rate of 5.4 million units, which was within striking distance of the record of 5.6 million units. This summer, housing starts were at their highest levels in 12 years. Despite the high level of building, supply is still lagging demand. The supply of new homes for sale has dropped to under four months, the lowest level recorded in the 36 years this data has been collected. And in some areas, housing backlogs are as long as a year. Ironically, the initial strength of the housing industry was partly attributed to rising mortgage interest rates. The idea being that rising rates would cause so-called fence sitters to jump into the housing market before rates rose even higher. While this may explain some of this industry's strong showing, sales have been too strong for too long to be explained by these fence sitters alone. Ultimately housing demand is determined by economic and demographic fundamentals. This summer's surge was no exception. It was fueled by plentiful jobs, low inflation, and high consumer confidence. Unfortunately, the cooling economy will take its toll on employment, inflation, and consumer confidence. This will cause housing starts and sales to retreat slowly over the forecast period.

International: Net trade is one of the few areas of concern. The U.S trade deficit continued its upward climb this summer, hitting $24.9 billion annually in July 1999 and $24.1 billion in August 1999. Ironically, while the expanding trade surplus is unquestionably a drag on the U.S. economy, it is also a result of the domestic economy's strength. The U.S. economy is not only the world's largest economy, but currently it is also the developed world's fastest growing economy. This being the case, it should come as no surprise that it is buying more from the rest of the world than it is selling abroad. The U.S. imported $164.3 billion more in goods and services than it exported last year. This deficit is forecast to rise by another $100 billion this year to $264.5 billion. This begs the question, "When, if ever, will the trade deficit shrink?" The answer lies in the expected performance of America's global trade partners. The European economies are starting to recover from their recent softness. Interestingly, the smaller countries in the European Union are showing the most strength. These have benefited from their lower cost of doing in business. As a result, Spain, Portugal, and Ireland are thriving while the core European economies remain soft. Asia has reported mixed results. It appears the region's "Little Tigers" have showed signs of recovery, most of which has been due to the strength of South Korea. China is expected to continue growing but at a slower pace than in recent years. This could cause China to consider devaluing its currency in an effort to keep itself competitive in order to speed up growth. Such a move would be dangerous, as it could set in motion a round of devaluations that would result in another Asian financial crisis. Japan remains the biggest wild card in Asia. While the world's second largest economy grew earlier this year, this is not a harbinger of future economic strength. Most of the growth in the first quarter of 1999 resulted from government measures. Absent this stimulus, growth evaporated in the second quarter of 1999. Japan's short-term outlook is not promising. For example, Japanese domestic demand has not recovered despite low interest rates. This being the case, the Japanese economy is not expected to recover until after next year. In Latin America, Brazil seems to be improving. Although the economy is in a recession, its currency has stabilized, interest rates have fallen, inflation has slowed, and its stock market has recovered to pre-devaluation levels. The Mexican economy has been slowing sharply as a result of tighter fiscal and monetary policies, but higher oil prices are helping the situation. Chile has suffered its first recession in 15 years because of the slump in commodity prices. The U.S. trade deficit is forecast to get worse before it posts a small improvement. Specifically, the merchandise and services trade deficit grows to $299.6 billion in 2000, $306.2 billion in 2001, $299.9 billion in 2002, and $290.6 billion in 2003.



Source: Standard & Poor's DRI

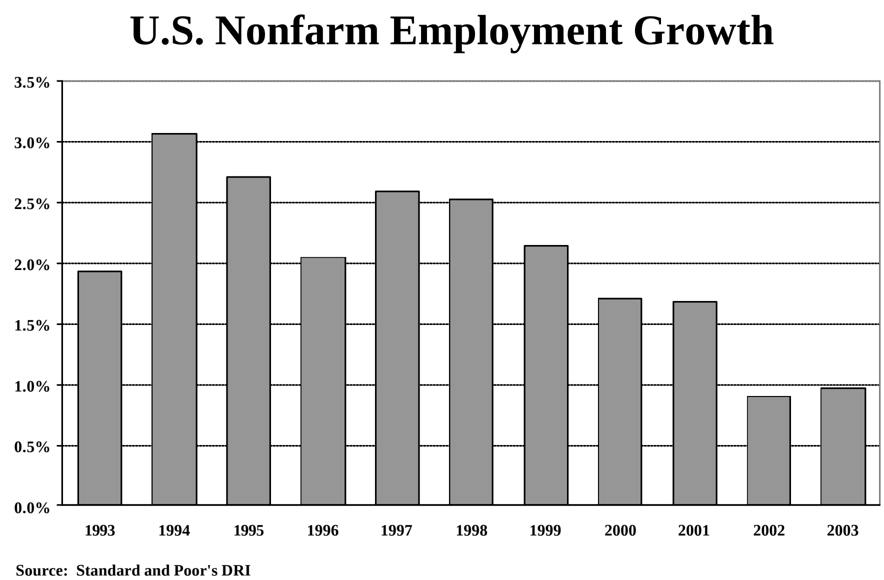
Inflation: Inflation is expected to rise from tepid to warm over the forecast period. Consumer price inflation has been below 3.0% since 1994. It actually dipped below 2% last year due to soft food prices and the collapse in oil prices. The current forecast shows it should remain beneath 3% through the forecast period. Specifically, consumer prices are forecast to rise just 2.2% this year, 2.5% next year, 2.3% in 2001, 2.5% in 2002, and 2.6% in 2003. Creeping inflation results from rising wage and benefit pressures as



Source: Standard and Poor's DRI

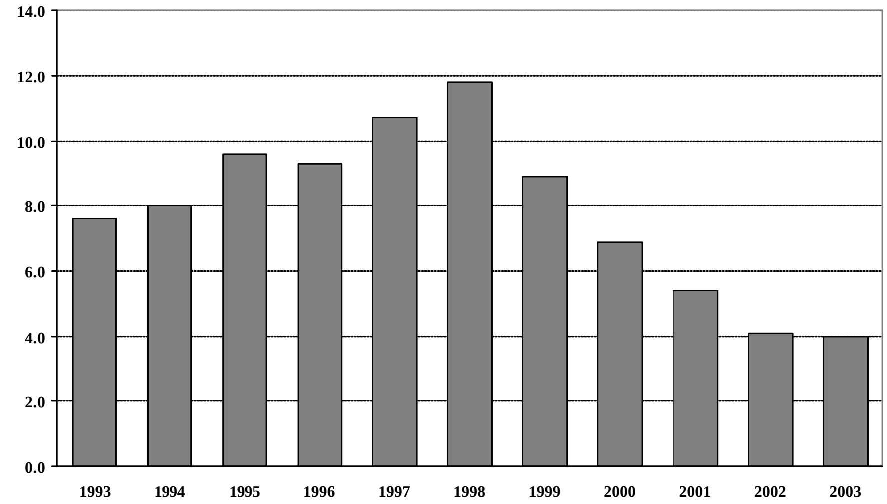
well as higher energy prices. During the last few years the employer cost index (wages, salaries, and benefits) grew by less than 4% annually thanks in large part to small benefit cost increases. This was caused by the switch from traditional fee-for-service health plans to managed care health services. However, price pressures are expected to return when this transition is complete. In addition, compensation will further reflect pressures brought on by the tight labor market. For example, unions are once again demanding both job security and higher wages for their members. And they have been successful in reaching these goals in several cases. For example, the Boeing machinists' union members received a 10% bonus, a 4% wage increase above the cost of living adjustment (COLA) for the first two years of the contract, and an additional 3% above COLA in the third year. Yet to come, several United Automobile Workers contracts are up for negotiations. Oil prices have also made a stunning comeback. Last winter crude prices plunged to around $10 per barrel. Currently, they stand near $25 per barrel, which is actually more than the $22 per barrel target OPEC had set. There are two major reasons for the price resurgence: the increased demand due to the Asian economic recovery and decreased supply caused by OPEC production cuts.

Employment: Employment has been one of the many bright spots in the glowing U.S. economy. After a slow start, the U.S. economy has added jobs with gusto. Over 17 million jobs were added from 1992 to 1998, an average annual increase of about 2.5%. Not surprisingly, the U.S. civilian unemployment rate has declined steadily from 7.5% in 1992 to 4.5% in 1998. Along the way, several milestones worth mentioning were passed. In 1996, the U.S. economy had attained full employment. This means that for the last three and a half years there has been a job for everyone who wanted one. In the second half of 1997, the civilian unemployment rate slipped under 5.0%. It has continued to decline since then. It averaged 4.9% in 1997 and 4.5% in 1998. For most of 1999, the civilian unemployment rate has been in the 4.2% to 4.3% range. While the constantly improving employment picture is welcomed, what is truly remarkable is that it has not rekindled inflation. Employment cost increases have remained under 4% thanks in large part to the relatively small increases in benefit costs. Unfortunately, it does not appear likely that employment can keep up its recent pace. For one thing, skilled employees are becoming harder to find and are demanding more from their employers. For example, unions have succeeded in negotiating for both job security and higher wages. Up until recently most of the attention was focused on job security. While it is believed that employment shall remain healthy over the forecast period, it is not expected to advance as fast as in the recent past. <u>The U.S. civilian unemployment rate is forecast to creep up to 4.7% by 2003, but this is still nearly a full percentage point below the 5.5% estimate of full employment</u>. <u>U.S. nonfarm employment is expected to rise 2.1% in 1999, 1.7% in 2000, 1.6% in 2001, 0.9% in 2002, and 1.0% in 2003</u>.



Business Investment: It may come as a surprise to some, but the most consistently performing sector during the expansion has been business investment. A review of several numbers brings this point home. Real business fixed investment has grown more than 8% annually during the expansion and investment in producers' durable goods has risen more than 10% annually over the last six years. As usual, much of this strength reflected the high-flying information processing equipment category that managed to rise an average of 16% per year since the current expansion’s start. In comparison, real consumer spending growth has averaged just 3.4% from 1992 to 1998. Given this pace of investment it is natural to question whether businesses have over shot their targets. A closer look at the data show, however, that American businesses are not putting all of the eggs in the high-tech basket. Indeed, the proportion of total spending on information systems has barely budged since 1984. This does not mean this sector is stagnant. In fact, this ratio has remained stable thanks to the plunging price of real computing power. The portion of producers’ durable equipment spending that has been increasing is transportation. It rose from 12% in 1990 to nearly 20% in 1998. However, this number should be used with caution because it also includes SUVs that are leased to consumers. In the near future, inventories will be worth watching. It is anticipated that companies will hedge against Y2K-related supply disruptions with higher on hand inventories. This should have a negative impact in the first part of next year. If supply disruptions are minor, businesses will curtail production and work down stockpiles. On the other hand, if there were major supply interruptions, output would suffer.

Real Business Investment Growth



Source: Standard and Poor's DRI